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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1946.

No. .....

No. .....

F. A. GILLESPIE AND SONS COMPANY, ***Petitioner,***

vs.

COMMISSIONER OF INTERNAL REVENUE, ***Respondent.***

PETITION FOR WRIT OF *CERTIORARI.*

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

F. A. Gillespie and Sons Company, the petitioner herein, by John E. Hughes and Harold E. Rorschach, its attorneys, respectfully prays that the writ of *certiorari* issue to review the judgments of the United States Circuit Court of Appeals for the Tenth Circuit in cases Nos. 3180 and 3181 in said Circuit Court of Appeals.

Short and Summary Statement of the Matter Involved.

POINT I.

In 1935 and 1936 petitioner deducted in its income tax returns from gross income, depreciation on equipment used in the operation of oil wells and also deducted depletion on the oil wells. For 1935, this depreciation amounted to $1,466.27 and for 1936 to $4,611.61. Percentage depletion deducted for 1935 was $5,441.51 and $10,194.98 for 1936. For

1935, its net loss was $18,644.65 and for 1936, its net loss was $27,243.77. For this reason, petitioner received no tax or other benefit from said depreciation or depletion deductions (R. 27, 28), but when it sold the property in 1937, respondent added the amounts of the 1935 and 1936 depreciation and depletion deductions to the selling price and forced petitioner to pay income tax in 1937 on the amounts of said depreciation and depletion deductions for 1935 and 1936, purporting to follow the 5 to 4 decision of this Court in *Virginian Hotel Company* v. *Helvering,* 319 U. S. 523 (wherein The Tax Court's view was overturned). The Tax Court and the court below affirmed this action of the Commissioner relying on this Court's decision.

Because (as more fully stated herein under reasons for granting the writ) the aforesaid decision of this Court has been generally conceded to go too far and to produce results not intended by Congress and to require reversal by this Court or by the Congress, this petition is filed for the purpose of requesting this Court to reexamine and modify its aforesaid decision at least to the extent of negativing any inference that it authorizes adding, in a year property is sold, prior year deductions to the profit derived from the sale, which deductions neither benefited taxpayer nor prejudiced the revenue.

Facts Bearing on Point 2.

The taxpayer acquired the Placedo oil and gas leases prior to the year 1937 and in drilling oil wells thereon had capitalized its portion of the drilling and development costs (R. 26-27). The taxpayer sold its interest in the property in 1937 for $200,000 cash, and reserved from the sale 1/8 of the 7/8 of the oil and gas produced therefrom until $275,000 should be received by the petitioner (R. 26). In computing the profit on the sale the capitalized drilling and development costs were proportioned, a part to the in-

terest sold and a part to the interest retained (R. 28-33), based upon the appraised value of the interest retained (R. 28).

Facts Bearing on Point 3.

Pursuant to a contract entered into on May 15, 1929, (R. 169) between the petitioner and F. A. Gillespie and Maud Gillespie, husband and wife, the last two transferred to petitioner bonds and sundry property having a value of $1,464,240.22, the cost of which to the Gillespies equaled or exceeded the above value (R. 34).

Under the terms of this contract the petitioner agreed to pay F. A. Gillespie $15,000 per year for life and to pay Maud Gillespie $15,000 per year for life. The Tax Court had previously determined that F. A. Gillespie was taxable on the basis of $15,000 per year as representing the taxable portion of the annuity payment. The United States Circuit Court for the Ninth Circuit determined that Maud Gillespie was taxable on the sum of $5,896.13 per year representing the taxable portion of the annuity payment received by her (R. 36). The Tax Court, affirmed by the Circuit Court, determined that the taxable portion of the annuity payments did not represent interest and was not deductible as such by this petitioner (R. 37).

Facts Bearing on Point 4.

In the recomputation of the tax by The Tax Court under Rule 50 the depletion allowance for the years 1937 and 1939 were reduced by an added amount of estimated overhead expense which was a new issue raised by the Commissioner of Internal Revenue. (R. 40-41 and 278-280)

Opinions Below.

The memorandum opinion of The Tax Court is not published but is printed in the record at pages 25 to 39.

The opinion of the Circuit Court of Appeals (R. 299 to 307) is published in 154 F. (2d) 913.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered March 12, 1946 (R. 307). A petition for rehearing was timely filed (R. 308) and was denied May 23, 1946 (R. 313). On August 8, 1946, this Court extended the time to file this petition until October 15, 1946. The jurisdiction of this Court is invoked under Section 240 (2) of the Judicial Code, as amended by the Act of February 13, 1925.

The Questions Presented.

First Question.

May excessive deductions for depreciation in prior years from which a taxpayer derived no tax benefit be added to taxable profit when taxpayer sells the property?

May depreciation and depletion deductions for 1935 and 1936 which did not reduce taxpayer's tax in those years be added to the 1937 income and taxed as profit on the 1937 sale without being a direct tax and void because not apportioned as required by the Federal Constitution?

Do such 1935 and 1936 deductions constitute gain, profit or income in 1937 within Section 22(a) of the Internal Revenue Code[a] or the Sixteenth Amendment to the Constitution?

Second Question.

Are capitalized drilling and development costs in case of oil and gas properties part of the leasehold investment, and in the case of a sale, must an allocation be made upon an assumed or hypothetical basis of such capitalized drill-

[a] or Section 22(a) of the Revenue Acts of 1936 and 1938.

ing and development costs, between the interest retained and the interest sold?

THIRD QUESTION.

Are the interest portions of the payments made by the taxpayer to F. A. Gillespie and his wife under the annuity contract of May 15, 1929, which consists partly of a return of capital and partly of interest, deductible by the taxpayer in the year in which paid?

FOURTH QUESTION.

May new issues be introduced in the recomputation of tax under Rule 50 of The Tax Court?

Statutes and Regulations Involved.

Section 113 of the Revenue Acts of 1936 and 1938 (R. 303) provided:

> "*Adjusted Basis for Determining Gain or Loss.*
>
> "(a) The basis of property shall be the cost of such property.
>
> "(b) *Adjusted Basis.* The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired; shall be the basis determined under subsection (a), adjusted as hereinafter provided.
>
> "1. *General Rule.* Proper adjustment in respect of the property shall in all cases be made * * *
>
> "(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws."

There is nothing in the regulations casting any light on the meaning of the word "allowed." (Reg. 101, Art. 113(b)-1.) And hence nothing is quoted.

Section 111 of the Revenue Acts of 1936 and 1938 provided:

(a) *Computation of Gain or Loss.* The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.* The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) *Recognition of Gain or Loss.* In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of Section 112.

Section 23 of the Revenue Acts of 1936 and 1938 provided:

(b) *Interest.* All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) and interest upon which is wholly exempt from the taxes imposed by this title.

Reasons for Granting the Writ.

It is believed that when it is brought to the attention of this Court that in the preponderant opinion of the bar and of other experts on a subject, a decision of this Court is clearly wrong, this great Court will willingly re-examine and consider correcting such decision itself and not leave its correction to Congress which in the last ten years has reversed more tax decisions of this Court than any other decisions since this Court was created, and at any rate this Court will not permit the extension of such decision to a state of facts not presented therein.

Reversal of the (5 to 4) decision in *Virginian Hotel Company* v. *Helvering*, 319 U. S. 523, has been recommended by both the American Bar Association (see Reports of the American Bar Association, 1943, Vol. 68, pages 166 and 167, quoted in appendix to this petition) and by The American Institute of Accountants (see The Journal of Accountancy, December, 1944, page 460, also quoted in this appendix).

That Congress intended by the provision of the statute governing this question only to prevent the correction of depreciation deductions in cases where the Statute of Limitations barred the collection of additional tax, see the Committee Report (quoted in the brief to this petition) and see also 56 Harvard Law Review, page 1164.

The majority opinion of this Court in the *Virginian Hotel* case reversed the considered opinion of the expert Tax Court and placed a construction on the word "allowed" contrary to a published ruling of the revenue bureau (see annexed brief).

In all justice to the majority of this Court, we believe, despite the burden of its vast volume of business, it would not have rendered the decision it did had the question been as fully and lucidly presented as we propose to present it, should this Court, in view of the foregoing, deem this obviously important question worthy of reexamination by it.

While for the foregoing reasons we believe the question should be reexamined even when arising on the same state of facts, *a fortiori* it should not be extended to tax as 1937 profit such deductions made in 1935 and 1936.

In the *Virginian Hotel* case the property was not sold, as it was here, and the excessive prior year deductions had not, as here, been added to income in the year of sale (1937) and it was not open to that taxpayer to make the point,

which we make here—that the Sixteenth Amendment to the Constitution authorizes only a tax on "income," that income in a current year is not created by excessive and illegal deductions, taken in prior years which neither reduce net income, benefit the taxpayer nor prejudice the Treasury, and that the statute as construed and applied by the court below, is not authorized by the Sixteenth Amendment to the Constitution, but levies a direct tax in violation of Article 1, Section 2, Clause 3 of the Constitution.

Taxpayer has been taxed in 1937 on $21,624.37 depreciation and depletion deductions for 1935 and 1936. Taxpayer never received a cent on account of these paper deductions nor anything of exchangeable or other value. It would have been as well off if it had not taken them and was no richer by taking them. In short, *they were not income* in any year, much less in 1937. This Court should not sustain a 1937 income tax thereon. The statute can only be upheld if construed not to impose it. Furthermore this is not income within the definition contained in Section 22(a) of the Internal Revenue Code. Excessive deductions, in prior years, which did taxpayer no good and the revenue no harm, do not fall within the definition of "Gross Income" in Section 22(a) of the Internal Revenue Code.

All of which is respectfully submitted.

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BRIEF IN SUPPORT OF PETITION FOR WRIT OF *CERTIORARI.*

A statement of the opinions below, jurisdiction and question presented is contained in the foregoing petition and is not repeated here.

Statement of the Case.

To the statement of the case contained in the foregoing petition, we add that The Tax Court refused to consider the uncontradicted evidence that excessive depreciation had been deducted in prior years because it considered this immaterial under the decision of this Court in the *Virginian Hotel* case. (R. 30)

A depreciation deduction is not "allowed" merely because no action on it is taken by the Commissioner.

Usually income tax returns disclosing a net loss are not sent to the field to be audited. Depreciation questions are handled by the Engineering or Valuation Section (Paul & Mertens, Vol. 5, Sec. 42.30) and where the affirmative disallowance of the entire deduction for depreciation would still leave a net loss, the depreciation question is not examined (Mimeograph 4170; C. B. XV-2, pp, 148, 149). In such case the deduction is neither allowed nor disallowed.

A deduction not considered is no more allowed than a claim filed in the Court of Claims or in any government department is "allowed" where it has not been acted on by the court or by the government bureau. Surely, a petition for certiorari or rehearing is not "allowed" in this Court where it has not been acted on. If so, why is a depreciation deduction allowed where not acted on?

Also, deductions are only such as are allowed by Section 23 of the Code and it does not allow and the Com-

missioner has no authority to allow an excessive deduction, depreciation or otherwise.

In S. M. 4249, C. B. IV-2, p. 15, the bureau ruled:

> "A deduction is not 'allowed' until it is passed upon and approved by the Commissioner."

See also G. C. M. 8573, C. B. IX-2, p. 168; G. C. M. 10754, C. B. XI-2, p. 177; G. C. M. 18611, C. B. 1937-1, p. 235.

Furthermore, the sole reason for the inclusion of the statutory provision here in question was to prevent taxpayers getting a double tax benefit by correcting excessive deductions for prior years after the right of the government to collect the tax they saved in prior years by such excessive deductions was outlawed. Senate Report 665, at page 29, states "the treasury should not be penalized for having approved taxpayer's deductions." See also 56 Harvard Law Review, p. 1164. See also Mertens, Volume 3, pages 637-638.

Also, this case is distinguishable from the *Virginian Hotel* case because here the excessive depreciation for prior years has been added to 1937 income and an income tax for 1937 imposed thereon, and we submit this is not income and that an income tax is not authorized by the Sixteenth Amendment to the Constitution on anything but income. Deductions for the year in issue, which alone were involved in the *Virginian Hotel* case, may depend on legislative grace, but adding an item to and taxing it as income in a year it was not deducted is another matter.

Certain it is that the ordinary citizen or the ordinary man who voted for the Sixteenth Amendment would not consider the amount of an excessive and illegal deduction in a prior year, which did not benefit the taxpayer or harm the revenue, to be taxable as income in a subsequent year. It is not "income" in any sense of the word.

Point II.

Where the taxpayer sells an oil and gas lease in which it has an investment in capitalized drilling and development costs and it retains an interest in the oil and gas to be produced from the lease until a specified amount is returned to it, the investment in capitalized drilling and development costs should not be prorated upon the ratio existing between the value of the interest sold and the value of the interest retained.

In view of the fugacious nature of oil and the necessarily contingent nature of oil payments to be received from the production of oil, if any, an allocation of drilling cost between cash received and the oil payments to be received out of production may result in taxpayer's failure to recover its drilling and development costs so allocated. If cost be not recovered, the taxation of a portion of the cash received as gain realized on the sale, would in effect be a tax upon capital and not upon income.(1)

The receipt of cash from the retained oil payment is so conjectural that its fair value cannot be included as a part of the gain realized from the sale, and the practical solution, is to first permit recovery of cost to the extent of cash received. This solution guarantees that the taxpayer at least will recover its cost to the extent of cash received and recovery of cost will not be dependent upon a wholly conjectural possibility. Thus the constitutional inhibition against the taxation of capital as income is preserved.

If tax laws are to be administered in a practical manner and upon an annual accounting basis, the taxpayer has realized gain on the sale of the oil leases for the taxable years 1937 and 1939 only to the extent of the cash received in excess of its costs. Any formula for the allocation of costs, however just and equitable though it may appear to be, which forces this taxpayer to postpone a recoupment of

(1) *Burnet* v. *Logan*, 283 U. S. 404, 75 L. ed. 1142; cf. *Thomas* v. *Perkins*, 301 U. S. 655, 81 L. ed. 1324.

its investment to the happening of unpredictable future events, which may never occur, is a direct violation of the Sixteenth Amendment and the Revenue Acts enacted pursuant thereto, which lay a tax upon income and not capital.

Point III.

Payments made by the taxpayer to the Gillespies under the contract of May 15, 1929, consist partly of the return of capital and partly of interest. The portion consisting of interest is deductible by the taxpayer in the year paid.

In deciding against the petitioner on the above issue the court below is in conflict with the Second Circuit in the case of *New England Life Insurance Co.* v. *Welch,* 153 F. (2d) 260;[2] the Second Circuit Court stating that where the taxpayer enjoys the use of money or some part of it over a period of postponement, and for this use it pays a compensation, then, in the ordinary parlance of the business world this payment would be called "interest on indebtedness," even though no obligation to pay anything arises until an installment falls due; and money owing constitutes indebtedness and the hire paid for it is commonly called interest during the time agreed for the loan to run as well as after that time has passed. In the former situation interest is compensation for the use of the money. In the latter it is compensation for the detention of it. But in both situations it is "interest on indebtedness" and deductible as being within the definition of "interest on indebtedness" as provided by statute.

(2) The Solicitor General appears to consider this decision as correctly stating the law as he announced no petition for *certiorari* would be filed. Prentice Hall Tax Service, April 4, 1946, par. 71063.

Point IV.

The court erred in redetermining the depletion allowance for the year 1937 and reducing said allowance in the amount of $2,181.73 and redetermining the depletion allowance for the year 1939 and reducing the allowance in the amount of $1,878.55.

The court erred in redetermining the depletion allowance for the year 1937, reducing the allowance for that year from $35,158.94 to $32,977.21 (R. 41-45) and in redetermining the depletion allowance for the year 1939, reducing the allowance set out in the 90-day letter from $36,699.72 to $34,821.17, (R. 278-281) said reduction being occasioned by an estimated additional overhead deduction. This issue was neither raised in the petitions nor was an affirmative plea made by the Commissioner of Internal Revenue in his answers with respect thereto, nor was any evidence offered in support thereof.

This reduction in the depletion allowance was a new issue which may not be raised after trial under a Rule 50 computation and is in conflict with the case of *Bankers Pocahontas Coal Co.* v. *Commissioner,* 287 U. S. 308, 77 L. ed. 325.

For the foregoing reasons, the writ should be granted and the case reversed with directions to The Tax Court to decide the amount of the excessive deductions in prior years and hold such amount not taxable in 1937, and also to apply the tax benefit theory to the balance of the deductions, and direct the Court to determine the profit on the sale without allocation of capitalized drilling and development costs.

All of which is respectively submitted.

John E. Hughes,
Harold E. Rorschach,
Counsel for Petitioners.

October 14th, 1946.

APPENDIX.

I.

Reports of American Bar Association 1943, Vol. 68, pp. 166, 167:

"Comment by the Section of Taxation: The purpose of the proposed amendment is to eliminate both retrospectively and prospectively the effect of *Virginian Hotel Corporation of Lynchburg* v. *Commissioner*, decided by the Supreme Court on June 7, 1943, in a 5 to 4 decision. The majority of the court there construes the word 'allowed' as used in Section 113(b)(1)(B), which provides that the basis of property shall be reduced by depreciation 'allowed (but not less than the amount allowable)' in prior years, to require a reduction of basis for the excessive depreciation previously deducted in error, even where the error did not benefit the taxpayer nor injure the Government. The result appears inequitable and contrary to the general rule consistently followed in tax cases that errors in prior year returns are always to be corrected and never carried forward except where some equity requires it. It is therefore believed legislation should be adopted to eliminate the effect of the court's construction of the present law."

II.

Recommendations by The Committee on Federal Taxation of The American Institute of Accountants. (The Journal of Accountancy, Dec. 1944, page 460:)

"The basis of property should not be reduced by excessive depreciation which resulted in no tax benefit.

"The requirement that excessive depreciation previously allowed be deducted in determining the basis of assets was included in the statute in order to prevent a taxpayer from obtaining a double deduction, with double tax benefit, of the same capital investment. However, that rule should not be applied when the excessive depreciation resulted in no tax benefit. The

reason for avoiding the inequitable result that formerly arose from the taxation of recoveries of bad debts and taxes, where no tax benefit had been obtained from the original deduction is equally applicable to excessive depreciation.

"For a detailed presentation of this recommendation and the arguments in its favor, reference is made to the annexed report of a subcommitee of this committee which was specially appointed to examine into this subject. (The subcommittee's report, which is omitted from this text, deals with the Supreme Court decision in the *Virginian Hotel Corporation* case and refers to amended statutory legislation proposed by the American Bar Association.)"

Montgomery Federal Taxes on Corporations 1944-45, p. 293:

"The decision has been rightly criticized as unnecessarily severe in that it penalizes the taxpayer for a mistake from which he derived no advantage."

Alexander Tax News Letter, Vol. VII, No. 50, 6/25/43:

"It is doubtful if from the ends of justice, a more unfair opinion than the *Virginian* case was ever rendered. * * * Even Godfrey N. Nelson, Tax Editor, N. Y. Times, very conservative, says Congress should enact corrective legislation and uphold Chief Justice STONE.

56 Harvard Law Review, p. 1164:

"It appears, however, that the mischief which the provision of the code in question was originally intended to correct was the situation where the taxpayer took the benefit of an excessive deduction to reduce tax liability, and then, after the Commissioner was barred from assessing a deficiency, claimed that his basis had been reduced only by the 'allowable' amount. * * * Since the excessive deductions were taken in loss years, the correction could be made without changing the tax liability for the prior years by computing the deductions

for future years as though the prior returns had been correct."

Extract From Depreciation Report of the Tax Committee of the American Mining Congress.[3]

Unless the property investment has been effectively recovered out of profits during the useful life of the property, the income of its period of usefullness has not been properly determined. The investment is not recovered out of losses but only out of profits.

The usefullness of the property will not be uniform throughout its life. Not every year will provide an equal fund from which recovery can be made. The law has very wisely made no attempt to lay down a specific formula or rule for determining the amount of depreciation which should be allowable for each year. It has only required that the allowance should be "reasonable" and it grants the reasonable allowance as a deduction from income. The difficulties come in determining the amount of that reasonable allowance, and this in turn rests to some extent on determination of the standard of reasonableness. It is to clarify this situation that the following recommendations are made:

The essence of the tax benefit rule is that no depreciation should be considered as having been allowed or allowable unless it gave a tax benefit; *i. e.*, unless it could be effectively applied to decrease taxable net income from the amount which would have been shown without such deduction.

As previously noted, recovery of basis for the property can only be made out of profits, since losses yield no fund from which investment can be recovered.

---

(3) Published by American Mining Congress, about June, 1946.

Definition of Income.

This Court has repeatedly defined "income" as used in the Sixteenth Amendment to mean "the gain derived from capital or from labor or from both combined provided it be understood to include profit gained through sale or conversion of capital assets."[4] Excessive paper deductions made in an earlier year do not fit this definition and do not become income in a later year.

This Court has said:

> "In determining the definition of the word 'income' thus arrived at, this Court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution."[5]

4. See Eisner v. Macomber, 252 U. S. 189, 64 L. ed. 521.

5. Merchants Loan & Trust Co. v. Smietanka, 255 U. S. 509, 519, 65 L. ed. 751, 755.

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720673—46——1

In the Supreme Court of the United States

OCTOBER TERM, 1946

Nos. 590 and 591

F. A. GILLESPIE AND SONS COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 25–39) are not reported. The opinion of the circuit court of appeals (R. 299–307) is reported at 154 F. 2d 913.

JURISDICTION

The judgments of the circuit court of appeals were entered on March 12, 1946 (R. 307–308). A petition for rehearing (R. 309–311) was denied

on May 23, 1946 (R. 313). By an order dated August 8, 1946, the time for filing petition for certiorari was extended to October 15, 1946 (R. 315). The petition for writs of certiorari was filed on October 9, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether this Court should reconsider its decision in *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, and whether that decision results in an unconstitutional tax in this case.

2. Whether, in determining gain from the sale of a partial interest in an oil and gas lease, a proportionate part of intangible drilling and development costs should be allocated to the retained interest in the property.

3. Whether, in making certain payments under annuity contracts, the taxpayer is entitled to a deduction for interest paid under Section 23 (b) of the Revenue Act of 1936 and the Internal Revenue Code.

4. Whether, on recomputation of the tax deficiencies, the Tax Court properly adjusted the depletion allowance for 1937 and 1939.

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes and regulations involved are set forth in the Appendix, *infra,* pp. 17–20.

STATEMENT

The Tax Court found the following facts:

In 1937, the taxpayer, an Oklahoma corporation, owned one-half of a seven-eighths working interest in eleven oil and gas leases in Texas, known as the Placedo leases. The remaining one-half of the seven-eighths working interest was owned by the Superior Oil Corporation which had drilled all the wells, except the first well, and had conducted the actual operations. (R. 26.)

The taxpayer and the Superior Oil Corporation each paid one-half of the drilling and development costs (R. 26). The taxpayer's share of the development costs had been capitalized in the amount of $142,467.80 (R. 27). In acquiring its interest, the taxpayer had incurred no original cost, or if it did, the cost was nominal and had not been capitalized (R. 26).

On June 15, 1937, the taxpayer sold its interest in the Placedo leases and in the leasehold equipment to Superior Oil Corporation. It received a cash consideration of $200,000, and reserved one-eighth of the seven-eighths of the oil and gas to be produced from the leases until the sum of $275,000 should be paid. No reservation was made with respect to the equipment. (R. 26.) From the date of the sale through March, 1944, the taxpayer received a total of $111,190.19 from the retained oil payment (R. 27).

The Tax Court found that, as of the date of the sale, the fair market value of the interest retained by the taxpayer in the Placedo leases was at least $100,000 (R. 27).

In its income tax returns for 1935, 1936, and 1937, the taxpayer had taken depletion, which was computed on the percentage basis, in the total amount of $19,673.29 for the Placedo leases (R. 27). In the deficiency determination, the Commissioner found that depletion for 1937 in the amount of $5,717.12, instead of $4,126.80, as taken by the taxpayer, was allowable, thereby making the total depletion allowance $21,263.61 (R. 28). The taxpayer's interest in the leasehold equipment had cost it $120,403.46, and deductions for depreciation thereon were taken in 1935, 1936, and 1937 in the total amount of $10,278.74 (R. 27).

In its tax return for 1937, the taxpayer reported a loss of $37,181.64 on the sale of its interest in the Placedo leases and in the equipment. This computation took no account of the value of the reserved interest in the leases or of the prior amount of depletion allowed. In the deficiency determination, the Commissioner computed gain from the sale in the amount of $45,780.73, having given a value of $100,000 to the interest reserved by the taxpayer, and having taken into account depreciation and depletion previously allowed (R. 28.)

Before the Tax Court, the Commissioner conceded that the computation was erroneous insofar as it failed to permit full recovery of the depreciated cost of the equipment before ascertaining the amount of taxable gain realized (R. 29.)

In 1939, the taxpayer was the owner of a lease, known as the Shear lease, which had no original or independent cost. During 1939, the taxpayer sold the lease, with the leasehold equipment thereon, for $49,950 cash, and retained an interest in one-eighth of seven-eighths of the production therefrom until the additional amount of $100,000 should be received. Leasehold development costs to the time of the sale amounted to $26,937.98. Of that amount, $22,439.71 had been capitalized, and the balance of $4,498.27 had been omitted. Depletion deductions taken by the taxpayer, and allowed by the Commissioner, with respect to the lease amounted to $1,345.85. The cost of the leasehold equipment to the time of the sale was $9,665.92, and the depreciation claimed and allowed with respect thereto was $483.30. In its income tax return for 1939, the taxpayer reported a gain of $19,449.66 on the sale of the lease. (R. 33.)

In ascertaining a deficiency, the Commissioner determined that the gain on the sale was $34,151.83. In making that determination, he concluded that the depreciated cost of the leasehold equipment was $9,182.62, that the leasehold cost, inclu-

sive of development cost, was $26,937.98, and was to be reduced by depletion allowances in an amount of $1,345.86, which would make a total net cost of the lease and the leasehold equipment of $34,774.75. He further determined that the value of the payments of $100,000 to be made from the one-eighth of the seven-eighths interest retained by taxpayer was $60,000, and that the value of the interest sold was $49,950, or $109,950 as the total value. Since the value of the interest sold represented 45.43 percent of the total value, he allocated such percentage, or $15,798.17 of the total cost of $34,774.75, to the cost of the interest. The balance of such cost, as determined by him, or $18,976.58, he allocated to the interest retained. Subtracting from $49,950, the selling price of the interest sold, the amount of $15,798.17, the portion of the total cost allocated to such interest, the Commissioner arrived at the gain stated above. (R. 33–34.)

The parties have stipulated that at the time of the sale the fair market value of the interest retained by taxpayer in the lease was $5,000, instead of the value of $60,000, determined therefor by the Commissioner (R. 34).

Pursuant to a contract entered into on May 15, 1929, between taxpayer and F. A. Gillespie and Maud Gillespie, husband and wife, there was transferred to taxpayer the following properties, of the indicated values, which were owned jointly (R. 34):

U. S. Liberty Loan bonds and Port of New Orleans State bonds	$1,172,000.00
Empress Building, Tulsa, Oklahoma	150,000.00
Sundry lands and lots located in Oklahoma	22,512.00
Cash and accounts receivable	94,365.22
Sundry stocks	25,363.00
Total	1,464,240.22

The cost of these properties to F. A. Gillespie and Maud Gillespie equaled or exceeded the fair market value (R. 34–35).

Under the terms of the contract, the taxpayer agreed to pay F. A. Gillespie $15,000 per year, for life, and to pay Maud Gillespie $15,000 per year, for life, and, in addition, guaranteed to her that she should receive annually for life as dividends, an amount equal at least to $10,000, and that, if for any reason funds should not be available for the declaration of dividends in that amount, the taxpayer would pay such sum to her (R. 35).

F. A. Gillespie was born on August 22, 1868, and Maud Gillespie, on June 9, 1872. An annuity upon the life of a male individual born in the United States on August 22, 1868, which would have paid $15,000 per annum to him for his life, could have been purchased from a reputable life insurance company doing business in the United States on May 15, 1929, for the sum of $153,750. An annuity upon the life of a female individual born in the United States on June 9, 1872, which would have paid $15,000 per annum to her for her

life, could have been purchased from a reputable life insurance company doing business in the United States on May 15, 1929, for the sum of $196,537.50. (R. 35.)

Under the terms of the contract of May 15, 1929, the taxpayer paid F. A. Gillespie a total of $54,375 for the years 1929 through 1932, and for the years 1933 through 1942, the amount of $15,000 per annum. The taxpayer paid Maud Gillespie for 1932, and for certain settlements to that time, a total of $34,891.01. For 1933, she was paid $25,000, and in November of that year she agreed that the taxpayer might cease paying her the additional $10,000 per annum, guaranteed to her as dividends or otherwise to be paid to her by taxpayer. However, in 1934, she was paid $20,000. For the years 1935 through 1940, she was paid $15,000 per annum. She died during 1941, and for the portion of the year ending with September, she was paid $12,250. (R. 35.)

The Tax Court decided, in computing gain on the sale of the leases, that proper adjustment was required to be made for the prior deductions taken for depletion and depreciation, without regard to whether any tax benefit had been received. It also held that a proportionate portion of the capitalized intangible drilling and development costs must be allocated to the taxpayer's retained interest in the leases. (R. 30–33, 34.) It likewise ruled that the amount of depreciation for

1937 which had been claimed by the taxpayer and allowed by the Commissioner was not shown by the taxpayer to be excessive (R. 30–31). It also decided that, on recomputation, the amount of depletion allowed for 1937 and 1939 was required to be adjusted in accordance with its decisions in the present cases (R. 49–50, 286–287).

The Tax Court further held that no part of the payments made in 1937 and 1939 to F. A. Gillespie and to Maud Gillespie under the annuity contracts could be deducted as interest paid (R. 36–37). The circuit court of appeals affirmed the decisions of the Tax Court in all respects (R. 299–307).

ARGUMENT

1. In *Virginian Hotel Co.* v. *Helvering,* 319 U. S. 523, it was held that Section 113 (b) (1) (B) of the Internal Revenue Code requires that the basis for property be adjusted to reflect all prior deductions for depreciation which were claimed in the taxpayer's return and which were not disallowed by the Commissioner. It was decided that the adjustment must be made even though the amounts previously deducted by the taxpayer were excessive and did not alter the tax liability which would have obtained if only a proper amount of depreciation had been taken in the prior years. While the *Virginian Hotel* case involved the basis for determining depreciation in the taxable year and the present case involves

the basis for determining gain on a sale, it is apparent that the cases are not distinguishable since the statute makes the same adjusted basis the reference point for both purposes. See Sections 113 (b), 23 (n), and 114 (b) (1) of the Internal Revenue Code and of the Revenue Act of 1936, Appendix, *infra*, pp. 18–19. Accordingly, the courts below were correct in deciding that the adjusted basis in this case must be determined in accordance with the principle of the *Virginian Hotel* case.

The taxpayer, however, contends that the *Virginian Hotel* case was erroneously decided and that the decision ought to be reconsidered (Pet. 6–8, 9–10). It is also argued that the effect of following that decision where gain on a sale is involved is to tax part of the return of the taxpayer's capital and that such a tax is repugnant to the Sixteenth Amendment to the Constitution of the United States as not being a tax on income (Pet. 8, 10).

At the outset, we wish to emphasize our conclusion that the record in this case does not present the question which the taxpayer is seeking to have reviewed. That is, the taxpayer contends that no adjustment in the basis of the property should be or can be made as the result of prior deductions for depreciation which were excessive and which did not give any tax advantage. The record, however, contains no convinc-

ing proof that the depreciation deductions in this case were excessive.[1] The Tax Court found that the taxpayer had not proved that depreciation for 1937, one of the tax years in controversy, had been claimed in an excessive amount; on the contrary, it held that the taxpayer's own evidence and method of computation showed that the amount of depreciation allowed for that year was properly allowable (R. 30–31). While the Tax Court made no express finding concerning the other years, the matter being properly considered irrelevant (R. 30), the same conclusions would be required for those years since the same type of evidence applicable to 1937 was the only proof offered respecting the prior years. Furthermore, it is not altogether correct to assume that the taxpayer received no tax advantage from the depreciation deduction which was claimed and allowed, for, as was pointed out in the *Virginian Hotel* case, 319 U. S. at 527, note 8, where such a deduction is only one of several claimed, they all actually produce the loss shown in the return.

At all events, we believe that it is reasonable and proper for Congress to provide that where a taxpayer has claimed and been allowed deductions for depreciation in prior years, he should not be permitted to assert that the physical depreciation which occurred was different from that claimed in

[1] Unlike the *Virginian Hotel* case, *supra*, the Commissioner has made no such determination here.

his prior tax returns. Once having claimed and been allowed the deduction, the taxpayer should not be permitted to take it again under either the guise of further depreciation or of diminution of gain actually realized on a sale. Nor is it unreasonable for Congress to refuse to differentiate between two taxpayers depending upon whether tax benefits resulted from the deductions. Both taxpayers have been allowed the deductions and should not be entitled to it again. Neither taxpayer is being taxed on capital where the basis for measuring gain excludes amounts previously taken as a deduction.

In requesting reconsideration of the *Virginian Hotel* decision, moreover, the taxpayer does not offer any new evidence of Congressional intent which was overlooked in that case and which would show that the Court was wrong in its interpretation of the statute. Indeed, it is of some significance that, although Congress enacted rules regarding certain of the so-called tax benefit situations, no changes were made in Section 113 (b) (1) (B) of the Internal Revenue Code. See Section 116 of the Revenue Act of 1942, c. 619, 56 Stat. 798.

2. In determining the amount of gain sustained by the taxpayer on the sale of a partial interest in certain oil leases (the taxpayer having retained, by way of an oil payment, the right to a portion

of production until a certain amount was repaid), the courts below followed *Columbia Oil & Gas Co.* v. *Commissioner*, 118 F. 2d 459 (C. C. A. 5th), and allocated only a portion of the leasehold basis to the interest sold and the remainder to the interest retained by the taxpayer. The taxpayer claims that the allocation should not have been made and that it must recoup its entire leasehold investment before there is any gain taxable under the Constitution (Pet. 11–12). *Burnet* v. *Logan*, 283 U. S. 404, relied on by the taxpayer (Pet. 11), in which the complete property interest was sold but only a partial payment was received at the time of the sale, has no application where, as here, only a partial interest was sold (*Thomas* v. *Perkins*, 301 U. S. 655; *Palmer* v. *Bender*, 287 U. S. 551; *Anderson* v. *Helvering*, 310 U. S. 404, 410–413), and complete payment therefor was made at the time of the transfer. Where a taxpayer sells only a portion of a divisible property interest which he owns, there is no requirement that his investment in the whole property be returned tax-free, or that the taxation of gain be postponed until a profit is realized on the interest retained. See *Heiner* v. *Mellon*, 304 U. S. 271, and the cases cited at 275–276, notes 3 and 4.

3. In consideration of the receipt of property having a value in excess of $1,400,000, the taxpayer contracted to pay two annuities which could have been purchased from a reputable life insur-

ance company at a total cost of $350,287 (R. 34–35). The taxpayer claims (Pet. 12) that it should be entitled to deduct, under Section 23 (b), as interest paid, the portion of the annuity payments which is taxed to the annuitant under Section 22 (b) (2).

The asserted conflict between the decision below and *New England Mut. Life Ins. Co.* v. *Welch*, 153 F. 2d 260 (C. C. A. 1st), does not exist. In that case, payment of the face amount of policies of insurance, otherwise due in a lump sum, could be postponed at the election of a beneficiary or an insured so that payment would be made over a period of time, the postponed amount bearing interest at the rate of three percent compounded annually. It was held that the stipulated element of interest was deductible by the company as interest paid on an indebtedness since this amount constituted extra compensation paid by the company for the use of borrowed money during the agreed term of the loan. In the present case, however, there was no loan or borrowing. *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552; *Deputy* v. *duPont*, 308 U. S. 488. Here the taxpayer's only obligation was to pay the annual installments when due; if the annuitant died before receiving back the price which was paid for the annuity, the taxpayer was relieved of further obligation. The concept of interest as "compensation for the use or forbearance of money" where

there is an indebtedness has no application to the present circumstances. See also *Deputy* v. *du-Pont, supra,* at p. 498; *Old Colony R. Co.* v. *Commissioner, supra.* Moreover, even if interest had been paid, there is no showing respecting the precise amount of the deduction to which the taxpayer would be entitled and it must be denied on that ground as well. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590. The decision below follows the decisions of other circuit courts of appeals and is clearly correct. *Autenreith* v. *Commissioner,* 115 F. 2d 856 (C. C. A. 3d); *Klein* v. *Commissioner,* 84 F. 2d 310 (C. C. A. 7th).

4. Certain issues which were raised by the taxpayer were decided, in part, in its favor by the Tax Court (R. 29, 34, 37–39). This resulted in altering the net income of the taxpayer from certain oil properties for the taxable years 1937 and 1939, and in changing its cost basis for certain oil interests. On recomputation of the tax deficiencies, the Tax Court, in order to give effect to its entire decision, recomputed the depletion allowance in accordance with the statutory provisions that the allowance, on a percentage basis, be 27½ percent of the gross income but not to exceed 50 percent of the net income from the property. Section 114 (b) (3) of the Internal Revenue Code and of the Revenue Act of 1936 (Appendix, *infra,* pp. 19–20). Where depletion was on a cost basis, it was computed in accordance with the basis as

determined in the decisions (R. 45, 281). It is thus clear, contrary to taxpayer's contention (Pet. 13), that no new issues were being raised on recomputation. Instead, the Tax Court was merely giving effect to the issues which were raised by the taxpayer and determined in its favor. This the Tax Court was required to do in deciding the issues before it and in determining the correct amount of the deficiency to be entered as the decision. See Rule 50, Rules of Practice Before the Tax Court (Revised to August 1, 1946) and Section 272 of the Internal Revenue Code.

CONCLUSION

The decision below is correct in all respects. There are no conflicts in decisions, and no substantial constitutional issue is presented for decision. Accordingly, the petition for writs of certiorari should be denied.

Respectfully submitted.

GEORGE T. WASHINGTON,
Acting Solicitor General.
SEWALL KEY,
Acting Assistant Attorney General.
J. LOUIS MONARCH,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

NOVEMBER, 1946.

APPENDIX

REVENUE ACT OF 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

* * * * *

(b) *Exclusions From Gross Income.*—The following items shall not be included in grass income and shall be exempt from taxation under this title:

* * * * *

(2) *Annuities, Etc.*—* * * Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this title or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity. * * *

* * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or

continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this title.

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale

or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(3) *Percentage Depletion For Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23 (m) be less than it would if computed without reference to this paragraph.

* * * * *

The corresponding provisions of the Internal Revenue Code are identical.

TREASURY REGULATIONS 94, promulgated under the Revenue Act of 1936:

Art. 113 (b)–1. *Adjusted basis: General Rule.*—* * *

* * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescense, amortization, and depletion to the extent such deductions have in respect of any period since February 28, 1913, been allowed (but such decrease shall not be less

than the amount of deductions allowable) under the Revenue Act of 1936 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. * * *

* * * * *

The provisions of Section 19.113 (b) (1)–1 Treasury Regulations 103, promulgated under the Internal Revenue Code, are substantially identical.

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SUPREME COURT, U. S.
FILED
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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 590, 591.

F. A. GILLESPIE AND SONS COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

BRIEF OF AMICUS CURIAE.

W. A. SUTHERLAND,
Amicus Curiae.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

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On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE.

The Undersigned respectfully moves this Honorable Court for leave to file the annexed brief as amicus curiae in the above entitled cause.

Respectfully submitted,

W. A. SUTHERLAND,
Amicus Curiae.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 590, 591.

F. A. GILLESPIE AND SONS COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

BRIEF OF AMICUS CURIAE.

This brief is filed in support of the first ground of the petition for certiorari wherein petitioner suggests that this court should reconsider and overrule its decision in *Virginian Hotel Corporation* v. *Commissioner*, 319 U. S. 523, and should not require Congress by new legislation to reassert what should be clear from the present statute, that a taxpayer's basis is reduced by excessive depreciation erroneously claimed in prior years only when some tax benefit was derived from the erroneous deduction. Especially should this court not sanction an extension of the *Virginian Hotel* decision to tax such erroneous paper deductions as income in a later year.

The petition sufficiently sets out that the language of the statute does not support the result reached by this court in the *Virginian Hotel* case; that the word "allowed" does not

embrace the mere insertion in a return of an erroneous deduction which may never reach the attention of the Commissioner; and that the legislative history of Section 113 (b)(1)(B) clearly shows that the purpose of the section was not at all to bind a taxpayer by an erroneous deduction which in no way affected tax liability, but only to prevent a taxpayer from getting the benefit of an erroneous depreciation deduction and then restoring it to basis so as to get the deduction again.

The petition, however, omits any refrence to one most important fact, which respondent will not dispute: If Section 113 (b)(1)(B) is to be construed as binding the taxpayer by an erroneous depreciation deduction shown on a return in a prior year where no benefit to the taxpayer nor injury to the Government resulted from the deduction, it constitutes the sole instance in 33 years of income tax legislation, administration and litigation where any branch of the Government has ever intimated that an *admitted error* in a prior year which had no tax effect should be permitted to affect income in a subsequent year. The Government has never suggested any reason why Congress should have wished to make an exception in this situation to an otherwise universal rule. That no reason for any such exception exists is at least strongly persuasive of the fact that the statute should not be so construed.

Congress never intended to tax such erroneous deductions as income, and maybe could not do so. One or two simple examples should make too clear for need of elaboration the unsoundness of the decision in the *Virginian Hotel* case and its application in the present case.

A taxpayer is not entitled to deduct any depreciation on a residence which he owns and occupies. Stated otherwise, no depreciation on such a residence is "allowable." But if an ignorant taxpayer inserts on his return a deduction of $1,000.00 for depreciation on such a residence, and if the return shows a loss even without such deduction, and if (as is generally the case with such returns) the Commissioner

does not check the return and it remains uncorrected, the taxpayer under the *Virginian Hotel* doctrine will be taxable on an income of $1,000.00 if the residence is sold at cost. No one will seriously suggest Congress intended this.

Take the case of a taxpayer who, by mathematical error in his depreciation computations or even by an error in transposing depreciation figures from his work papers to the return, shows on his return a deduction for depreciation in excess of the correct depreciation which he intended to claim. Unless the Commissioner discovers and corrects this erroneous deduction prior to the expiration of the limitations period, it will decrease the basis of the property and increase income in future years, although the erroneous insertion of the deduction on the return did not benefit the taxpayer nor prejudice the Government.

Thus it will be seen that the *Virginian Hotel* decision makes a mockery of the principle so often announced by this court, the principle that taxation is a practical matter dependent upon actualities and not upon erroneous entries in books or on returns. The decision should be reconsidered in the light of its application by the courts below and overruled or at least held to have been extended to a length this court did not foresee. The desirability of such action is especially apparent in view of the fact that in the case of *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), decided since the *Virginian Hotel* case, this court has disapproved the decision of the fourth circuit in *Helvering* v. *State-Planters and Trust Co.*, 130 F. (2d) 44, which was the only authority referred to by this court in its *Virginian Hotel* opinion in support of its interpretation of the word "allowed".

Respectfully submitted,

W. A. Sutherland,
Amicus Curiae.

October, 1946.

FILE COPY

DEC 11 19

Nos. 590-591

In the Supreme Court of the United States

October Term, 1946.

F. A. GILLESPIE AND SONS COMPANY, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REHEARING FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1946.

Nos. 590 and 591.

F. A. GILLESPIE AND SONS COMPANY, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REHEARING FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Comes now, F. A. Gillespie and Sons Company, the petitioner in the above entitled cases, and presents this its petition for rehearing on its application for petition for writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit in Cases Nos. 3180 and 3181 in said Circuit Court of Appeals and in support thereof respectfully shows that:

The court erred in its conclusion that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit should be denied in the following manner, to-wit:

Petition for writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit was filed in the Supreme Court of the United States, October Term, 1946, on the 9th day of October, 1946, and thereafter on the 18th day of November, 1946, the Supreme Court of the United States denied the petitioner's petition for said writ of certiorari. The court erred in denying the said application of the petitioner for writ of certiorari for the following reasons:

I.

The decision of the court below is in conflict with the decision of the *Pittsburg Brewing Company* case, 107 F. (2d) 155, decided by the Circuit Court of Appeals for the Third Circuit and the court below is also in conflict with the *New England Life Insurance Company* v. *Welch,* 153 F. (2d) 260, decided by the Circuit Court of Appeals for the Second Circuit.

II.

The court below, in petitioner's cases, has decided an important question of Federal income tax law which is in conflict with the Circuit Courts of Appeal for the Second and Third Circuits and in view of the importance of the questions of interest deductions and excessive depreciation deductions made in prior years and added to taxpayer's current year's income and taxed as a profit should be authoritatively settled by this Court.

The court below has decided that excessive depreciation and depletion deductions taken in prior years constitute gain or profit on income in subsequent years, which petitioner urges is violative of the Sixteenth Amendment to the Constitution.

Wherefore, petitioner prays that this Court grant a rehearing on petitioner's petition for writ of certiorari and upon a rehearing enter an order granting the petition for

writ of certiorari; in support of which a brief is filed concurrently herewith.

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December 9, 1946.

CERTIFICATE OF COUNSEL.

The undersigned, record counsel for the appellant herein, does hereby certify and declare that the petition for rehearing filed in the proceeding in the instant cases is filed in good faith and not for any purposes of delay or injustice.

.....
HAROLD E. RORSCHACH,
Attorney for Appellant.

BRIEF IN SUPPORT OF PETITION FOR REHEARING.

A statement of the opinion below, jurisdiction and questions presented is contained in the petition for writ of certiorari and is not repeated here, for which reference is made to pages 6, 7, 8 and 9 of the printed copy of the petition for writ of certiorari.

In these cases, excessive deductions for depreciation taken in 1935 and 1936 and from which the taxpayer received no tax benefit, was added by the Commissioner of Internal Revenue to the taxable profit when taxpayer sold its oil properties in the year 1937. The Tax Court approved the Commissioner's determination and was affirmed by the Circuit Court of Appeals, relying upon the 5 to 4 decision

of this Court in the *Virginian Hotel Company* v. *Helvering*, 319 U. S. 523. Reversal of the 5 to 4 decision in the *Virginian Hotel Company* case has been recommended by the American Bar Association, the American Institute of Accountants, and has been criticized by The Tax Committee of the American Mining Congress. (Appendix of Petition for Writ.)

The *Virginian Hotel Company* case placed a construction on the word "allowed" as opposing the construction of the word "allowed" in the *Pittsburg Brewing Company* case. Such construction was placed by this Court on the word "allowed" only in event the excessively depreciated property was owned and retained by the taxpayer for the current taxable year. Construction of the word "allowed" was not determined in the *Virginian Hotel Company* case in event of the sale of the depreciable property.

We do not believe that the majority of this Court intended the extension of the doctrine in the *Virginian Hotel Company* case where the property was sold as it was here and the excessive prior years' deductions added to income in the year of sale and it was not open to the taxpayer in that case to make the point which we make here that the Sixteenth Amendment to the Constitution authorizes only a tax on "income" and that income in a current year is not created by excessive and the illegal deductions taken in prior years which neither produces net income, benefits the taxpayer nor prejudices the Treasury.

Taxpayer has been taxed in 1937 on $21,624.37 excessive depreciation and depletion deductions for 1935 and 1936. Taxpayers never received one cent on account of these paper deductions and it would have been as well off if it had not taken them and was no richer by taking them. In short, these excessive deductions were not income in any year, much less in 1937, and this Court should not sustain the imposition of a 1937 income tax thereon.

It would seem startling and shocking that in a field of law which is so important such a vital question would be

conclusively determined without, (*a*) full opportunity for the litigants to be heard in all of the ways prescribed by law, one of which is by oral arguments in the Court; and (*b*) a careful examination of the case on the merits.

Excessive deductions in prior years which did taxpayer no good and the revenue no harm cannot be added to later years' income and do not fall within the definition of "gross income" as provided for in Section 22(a) of the Internal Revenue Code.

All of which is respectfully submitted,

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